IN THE

Supreme Court of the United States

October Term, 1941

No. 503

PALM SPRINGS HOLDING CORPORATION,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT AND BRIEF IN SUPPORT THEREOF.

THOMAS R. DEMPSEY,
1104 Pacific Mutual Building, Los Angeles,
Attorney for Petitioner.

SUBJECT INDEX.

PAGE

Petition for Writ of Certiorari 1

Summary statement of matter involved 1

Jurisdiction 6

Questions presented 7

Reasons relied on for the allowance of the writ 9

Brief in Support of Petition for Writ of Certiorari 13

Opinions of the court below 13

Jurisdiction 14

Statement of the case 14

Assignments of error 14

Summary of argument 16

Argument 17

The Circuit Court erred in refusing to hold that the steps by which the petitioner acquired all the property of the two old corporations constituted a tax-free reorganization which entitles the petitioner to use the adjusted bases of the old companies in computing its depreciation for income tax purposes 19

The Circuit Court of Appeals for the Ninth Circuit has decided an important question of federal law which has not been, but should be, settled by the Supreme Court of the United States 24

Conclusions 25

TABLE OF AUTHORITIES CITED.

CASES. PAGE

Altshuler, B. T. A. Memo. Docket, No. 84568 (C. C. H. 10432-C) 10

Commissioner v. Alabama Asphaltic Limestone Co., Inc., 119 Fed. (2d) 819 (C. C. A. 5th) 9, 15, 21, 25

Commissioner v. James Q. Newton, 42 B. T. A. 473 ..... 23, 25

Commissioner v. Janes Q. Newton Trust, ... Fed. (2d) ..... (C. C. A. 10th) 9, 21

Commissioner v. Kitselman, 89 Fed. (2d) 458 (C. C. A. 7th) 8, 9, 10, 11, 15, 20, 21, 24

Commissioner v. Newberry L. & C. Co., 94 Fed. (2d) 447 (C. C. A. 6th) 8, 9, 10, 15, 20, 21

Commissioner v. New Haven and Shore Line Railway Co., ... Fed. (2d) ..... (C. C. A. 2d), decided July 21, 1941, reported in Prentice-Hall 1941 Tax Service, Par. 62,841 ..... 9, 21, 22, 25

Commissioner v. Palm Springs Holding Corp., 119 Fed. (2d) 846 21

Commissioner v. Southwest Consolidated Corp., 119 Fed. (2d) 561 (C. C. A. 5th) 9, 15, 21, 25

Commissioner of Internal Revenue v. Marlborough House, Inc., 118 Fed. (2d) 511 21

Helverding v. Tyng, 308 U. S. 527 ..... 8, 15, 21, 23, 25

Howard Hotel Corp., 39 B. T. A. 1147 10

Leckie, In re, 37 B. T. A. 252 10

LeTulle v. Scofield, 308 U. S. 415 ..... 8, 10, 11, 15, 21, 23, 24, 25

Post Office Building Co., B. T. A. Memo. Docket No. 93083 (C. C. H. 10795-B) 10

Southwest Consolidated Corp., B. T. A. Memo. Docket No. 93321 (C. C. H. 10808-I) 10

Sunstein, B. T. A. Memo. Docket, No. 82529 (C. C. H. 9954-E) 10

York Furniture Co., B. T. A. Memo. Docket No. 92778 (C. C. H. 10825-B) 10

MISCELLANEOUS. PAGE

C. C. H. Illustrative Bulletin E, May 8, 1940 24

18 Tax Magazine 492, Income Tax Problems of Reorganization, Virgil S. Chandler, December, 1940, University of Kansas City Law Review, Vol. IX, p. 22 24

STATUTES.

Judicial Code, Sec. 240(a), as amended by Act of February 13, 1925, Chap. 229, Stat. 938 (28 U. S. C. A., Sec. 347(a)) 6, 14

Revenue Act of 1932, Sec. 112(b)(3) 7

Revenue Act of 1932, Sec. 112(b)(4) 7

Revenue Act of 1932, Sec. 112(i) 7

Revenue Act of 1932, Sec. 112(i)(1)(2) and (j) 7, 19

Revenue Act of 1932, Sec. 113(a)(7) 7, 19

Revenue Act of 1934, Sec. 113(a)(12) 7, 19

Revenue Act of 1934, Sec. 114(a) 19

Revised Statutes, Sec. 1008, as amended (28 U. S. C. A., Sec. 350) 6, 14

INDEX TO APPENDIX.

Revenue Act of 1932, 26 U. S. C. A., Sec. 112 3

Revenue Act of 1932, 26 U. S. C. A., Sec. 113 3

Revenue Act of 1932, 26 U. S. C. A., Sec. 114 2

Revenue Act of 1934, 26 U. S. C. A., Sec. 23 1

Revenue Act of 1934, 26 U. S. C. A., Sec. 113 2

Revenue Act of 1934, 26 U. S. C. A., Sec. 114 1

Revenue Act of 1936, 26 U. S. C. A., Sec. 1 1

IN THE

Supreme Court of the United States.

October Term, 1941

No. .....

PALM SPRINGS HOLDING CORPORATION,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI.

To the Honorable, the Chief Justice and the Associate Justices of the Supreme Court of the United States:

The petition of PALM SPRINGS HOLDING CORPORATION, a corporation, respectfully represents:

Summary Statement of Matter Involved.

The controversy here involved relates to a deficiency in Federal income taxes and excess-profits taxes of the petitioner for the fiscal year ended May 31, 1936, in the sum of $3612.78. [R. 5.]

The Palm Springs Hotel Co., a corporation, was the owner of a hotel. In July, 1932, the corporation had outstanding $309,000.00 of its first mortgage bonds which were a lien upon the hotel property. The hotel was leased

to another company known as the El Mirador Hotel Operating Co., which owned the furniture and fixtures. To secure the performance of the terms of the lease, the El Mirador Hotel Operating Co. gave a chattel mortgage upon the said furniture and fixtures to the said Palm Springs Hotel Co. This latter company in turn pledged the lease and chattel mortgage as part of the security for its said bond issue. [R. 23.]

In the Spring of 1931 both the Palm Springs Hotel Co. and the El Mirador Hotel Operating Co. were in financial difficulties and were unable to meet their respective obligations, having sustained large operating deficits. [R. 24.] Under date of August 20, 1931, a bondholders protective committee for Palm Springs Hotel Co. first mortgage seven per cent s. f. gold bonds was formed to protect the interests of the holders of said bonds. [R. 25.] A copy of the bondholders' deposit agreement is set forth at pages 70 to 73 of the record.

The petitioner was formed under the laws of the State of California on April 1, 1932 [R. 22 and 25], pursuant to a plan of reorganization for the purpose of acquiring said bonds and ultimately all of the properties of said Palm Springs Hotel Co. and of the El Mirador Hotel Operating Co. During the month of May, 1932, the petitioner issued all of its preferred shares and part of its common shares in exchange for $292,000.00 par value of said bonds. [R. 26.] The remainder of its common shares were issued to R. D. Lacoe in consideration for his agreement to pay up to $1,000.00 the costs of incorporating the petitioner and for his agreement to lend moneys to the petitioner. Lacoe was also a holder of a large block of the bonds for which the other shares were issued. [R. 26 and 27.]

On or about July 15, 1932, petitioner was the successful bidder at a Trustee's sale of all of the properties of Palm Springs Hotel Co. held pursuant to the terms of the indenture securing said bonds. The bid price was $61,800.00, which was paid as follows:

(a) Payment of cash amounting to $18,767.96

(b) By the delivery to the Trustee of bonds of Palm Springs Hotel Co. having a face value of $292,000.00 for the balance of 43,032.04

$61,800.00

The said properties were acquired subject to obligations prior to the lien of the bonds amounting to $38,949.76, of which amount $13,500.00 constituted a lien against furniture and fixtures. [R. 27 and 28.]

Among the assets acquired by the petitioner at the Trustee's sale were the said lease, the indebtedness thereon and the said chattel mortgage. [R. 27 and 28.]

On August 2, 1932, the taxpayer foreclosed on the chattel mortgage on the furniture and fixtures. [R. 28.] At the foreclosure sale the furniture and fixtures were sold to the taxpayer pursuant to a decree of foreclosure for a bid price of $20,179.25. [R. 28.] The amount of the judgment for the indebtedness of the El Mirador Hotel Operating Co. under the lease and chattel mortgage was $77,918.79. [R. 28.] The furniture and fixtures constituted all of the properties of the El Mirador Hotel Operating Co. [R 27.]

The properties formerly owned by Palm Springs Hotel Co. and acquired by petitioner as aforesaid constituted

what is known as the El Mirador Hotel at Palm Springs, California. [R. 23.]

All of the capital stock of Palm Springs Hotel Co. and El Mirador Hotel Operating Co., excepting in each case ten (10) shares of capital stock owned by Warren B. Pinney, who was president of both companies, had been forfeited for nonpayment of assessments levied against the shares, so that at the time petitioner was organized said Pinney was the sole stockholder of both corporations. [R. 24 and 25.] Said Pinney received no capital stock of petitioner for his holdings of capital stock of either of the two predecessor corporations, nor did any other stockholders of such corporations receive any shares of petitioner for any rights which they may have had as such stockholders. [R. 29 and 30.] Said Pinney received 1,000 shares of common stock of petitioner from R. D. Lacoe for his services in the reorganization and as an inducement to continue as manager of the hotel. [R. 29.]

The petitioner on its Federal income tax return for the year under review deducted depreciation upon the hotel buildings and the furniture and fixtures upon the bases of the two predecessor corporations. [R. 15.]

The cost to Palm Springs Hotel Co., including all additions up to July 15, 1932, of the buildings which were acquired by petitioner as aforesaid was $686,731.97. Subsequently the petitioner, up to May 31, 1936, expended $82,652.81 for additions to said buildings. The useful life of the buildings was twenty years from January 1, 1928. [R. 29.]

The cost to El Mirador Hotel Operating Co. including all additions up to August 2, 1932, of the furniture and fixtures acquired by petitioner on the date named was $232,544.10. Subsequently petitioner acquired additional furniture and fixtures up to May 31, 1936, at a cost of $40,485.18. The useful life of said furniture and fixtures was twelve years from the date of acquisition new. [R. 29.]

Upon the examination of the return, the Commissioner of Internal Revenue disallowed the depreciation upon the basis mentioned and based his determination of deductible depreciation upon the said furniture and fixtures for income tax purposes upon what he claimed to be the fair market value thereof as of the date of foreclosure of the chattel mortgage. [R. 15.]

The amount of depreciation on the said items allowed by the Commissioner was $15,892.97 [R. 15], based on a revised cost of the furniture and fixtures to May 31, 1935, of $126,774.21, plus additions during the taxable year of $11,334.46, or a total cost of $138,108.67. These figures were based upon the valuation of the items at the date of foreclosure plus subsequent additions. [R. 15.]

From the Commissioner's determination the petitioner appealed to the United States Board of Tax Appeals. The Board decided the issue of depreciation with respect to furniture and fixtures in favor of the Commissioner holding that the taxpayer must use as the basis for depreciation of such items the fair market value thereof

as of the date of foreclosure, plus cost of additions. [R. 4 to 20.]

The United States Board of Tax Appeals determined the issue with respect to the building in favor of the petitioner herein, holding that the petitioner was entitled to use its predecessor's adjusted base for tax purposes. [R. 30, 31 and 32.]

Both the Commissioner and the petitioner sought reviews by the United States Circuit Court of Appeals for the Ninth Circuit of the portion of the decision of the Board of Tax Appeals which was adverse to them respectively. [R. 36, 46.] The Circuit Court ordered the proceedings under the two petitions consolidated. [R. 67, 68.]

The United States Circuit Court of Appeals for the Ninth Circuit reversed the Board's decision and remanded the case for further proceedings. The Circuit Court held in effect that there was no tax free reorganization and the petitioner was not entitled to use its predecessor corporations' bases for the purpose of computing deductible depreciation of buildings, furniture and fixtures.

Jurisdiction.

1. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925, Chapt. 229, Stat. 938, 28 U. S. C. A. Section 347 (a); Rev. Stat. Section 1008 as amended (28 U. S. C. A. Section 350).

2. The date of the entry of the judgment of the Circuit Court of Appeals of the Ninth Circuit herein sought to be reviewed is May 14, 1941. [R. 96.]

Questions Presented.

1. Did not the Circuit Court of Appeals of the Ninth Circuit err in holding that the petitioner (Palm Springs Holding Corporation) did not acquire the hotel buildings in connection with a reorganization as that term is defined in Section 112 (i) of the Revenue Act of 1932, so that the basis for depreciation of the property in its hands is the same basis as that of the Palm Springs Hotel Co., prior owner, pursuant to Section 113 (a) (12) of the Revenue Act of 1934; Sections 112 (b) (3) and (4) and 113 (a) (7) of the Revenue Act of 1932; and Section 112 (i) (1) (2) and (j) of the Revenue Act of 1932?

2. Did not the Circuit Court of Appeals of the Ninth Circuit err in holding that the petitioner (Palm Springs Holding Corporation) did not acquire the hotel furniture and equipment in connection with a reorganization as that term is defined in Section 112 (i) of the Revenue Act of 1932, to which the El Mirador Hotel Operating Company was a party, so that the basis for depreciation of the property in its hands is the same basis as that of the El Mirador Hotel Operating Company, a prior owner, pursuant to Section 113 (a) (12) of the Revenue Act of 1934; Section 112 (b) (3) and (4) of the Revenue Act of 1932; and Sections 112 (i) (1) (2) and (j) and 113 (a) (7) of the Revenue Act of 1932?

3. Did not the Circuit Court of Appeals of the Ninth Circuit err in holding that this case was not controlled by the cases of *Commissioner v. Newberry L. & C. Co.*, 94

Fed. (2d) 447 (C. C. A. 6th), and *Commissioner v. Kitselman*, 89 Fed. (2d) 458 (C. C. A. 7th)?

4. Did not the Circuit Court of Appeals of the Ninth Circuit err in holding that the case of *LeTulle v. Scofield*, 308 U. S. 415, and *Helvering v. Tyng*, 308 U. S. 527, overruled the cases of *Commissioner v. Kitselman, supra*, and *Commissioner v. Newberry L. & C. Co., supra*?

5. Did not the Circuit Court of Appeals of the Ninth Circuit err in holding in the present case the stockholders of the transferor corporations got nothing?

6. Did not the Circuit Court of Appeals of the Ninth Circuit err in holding that the basis for depreciation of said real and personal property was the cost of such property to the petitioner?

7. Were the furniture and fixtures of the El Mirador Hotel Operating Co. and the building of the Palm Springs Hotel Co. acquired by the petitioner in 1932 in connection with a reorganization such as would entitle the petitioner to use the same basis for depreciation of the said real and personal property so acquired as was available to the said El Mirador Hotel Operating Co. and the Palm Springs Hotel Co.?

Reasons Relied on for the Allowance of the Writ.

1. The decision of the Circuit Court of Appeals for the Ninth Circuit is in conflict with the following decisions on the same question in other Circuits:

Commissioner v. Newberry L. & C. Co., 94 Fed. (2d) 447 (C. C. A. 6th);

Commissioner v. Kitselman, 89 Fed. (2d) 458 (C. C. A. 7th). Certiorari denied 302 U. S. 709;

Commissioner v. Southwest Consolidated Corporation, 119 Fed. (2d) 561 (C. C. A. 5th), decided April 19, 1941;

Commissioner v. Alabama Asphaltic Limestone Company, Inc., 119 Fed. (2d) 819 (C. C. A. 5th), decided May 5, 1941;

Commissioner v. New Haven and Shore Line Railway Company, ... Fed. (2d) ..... (C. C. A. 2nd), decided July 21st, 1941, reported in Prentice-Hall 1941 Tax Service, Par. 62,841; and

Commissioner v. James Q. Newton Trust, ... Fed. (2d) ..... (C. C. A. 10th), decided July ....., 1941.

2. The decision of the Circuit Court of Appeals for the Ninth Circuit in this case departs from a long line of authorities, beginning with the case of *Commissioner v. Kitselman, supra*, and including the following decisions of the United States Board of Tax Appeals upon the right of a taxpayer to use a predecessor corporation's basis for

assets through the medium of a foreclosure of a bond issue.

In re Leckie, 37 B. T. A. 252;

Howard Hotel Corp., 39 B. T. A. 1147;

Sunstein, B. T. A. Memo Docket, No. 82529 (C. C. H. 9954-E, February 1938);

Altshuler, B. T. A. Memo Docket, No. 84568 (C. C. H. 10432-C, August 27, 1938);

Post Office Building Co., B. T. A. Memo Docket No. 93085 (C. C. H. 10795-B, July 28, 1939);

Southwest Consolidated Corp., B. T. A. Memo Docket No. 93321 (C. C. H. 10808-I, August 25, 1939);

York Furniture Company, B. T. A. Memo Docket No. 92778 (C. C. H. 10825-B, September 18, 1939).

3. The petitioner is of the belief that the Circuit Court of Appeals for the Ninth Circuit is in error in holding that the case of *LeTulle v. Scofield*, 308 U. S. 415 overruled the *Kitselman* and *Newberry* cases, *supra*.

4. The principle that a reorganization resulting from the foreclosure of a corporate bond issue entitles the successor corporation to use the basis of the predecessor corporation for purposes of computing depreciation is of widespread application and affects a large number of taxpayers, and since the decision in the present case is wholly at variance with the decisions of several other Circuits and with the long line of decisions of the United

States Board of Tax Appeals, it seems fitting that the conflict should be settled. The petitioner is further of the opinion that the facts of the *LeTulle* case, *supra,* are not at all comparable to the facts in the *Kitselman* and *Newberry* cases, *supra,* or the facts in the case at Bar.

5. There is now pending and undetermined before your Honorable Court the petition for writ of certiorari in the cases of *Bondholders Committee, Marlborough Investment Company, First Mortgage Bonds v. Commissioner of Internal Revenue,* and *Marlborough House, Inc., a corporation v. Commissioner of Internal Revenue,* in which cases the United States Circuit Court of Appeals for the Ninth Circuit on March 8, 1941, decided the question similar to the one involved in the present case against the taxpayer.

Wherefore, your petitioner respectfully prays that a writ of certiorari be issued out of and under the seal of your Honorable Court directed to the United States Circuit Court of Appeals for the Ninth Circuit commanding that Court to certify and send to your Honorable Court, on a day certain to be therein named, a full and complete transcript of the record of all proceedings in the case of *Commissioner of Internal Revenue,* Petitioner v. *Palm Springs Holding Corporation,* Respondent, and *Palm Springs Holding Corporation,* Petitioner, v. *Commissioner of Internal Revenue,* Respondent, bearing Docket No. 9661, to the end that the judgment of the United States Circuit Court of Appeals for the Ninth Circuit may be

reviewed and reversed by your Honorable Court, and for such other and further relief as may seem meet and proper.

And your petitioner will ever pray, etc.

PALM SPRINGS HOLDING CORPORATION,
By THOMAS R. DEMPSEY,
Attorney for Petitioner.

The undersigned counsel of record hereby certifies that the foregoing petition is well founded and is not interposed for the purpose of delay.

THOMAS R. DEMPSEY,
Attorney for Petitioner.

IN THE

Supreme Court of the United States

October Term, 1941

No. .....

PALM SPRINGS HOLDING CORPORATION,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

Opinions of the Court Below.

The decision of the United States Board of Tax Appeals was favorable to the petitioner in respect of the buildings and adverse as to the furniture and fixtures. The opinion of the United States Board of Tax Appeals is a memorandum decision and is unreported; it is dated March 23, 1940. [R. 30.]

The judgment of the Circuit Court of Appeals for the Ninth Circuit in the matter was adverse to the petitioner on both issues. The opinion of the Circuit Court of Appeals for the Ninth Circuit is reported in 119 Fed. (2d) 846. [R. 88.]

Jurisdiction.

1. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by Act of February 13, 1925, 43 Stat. 938, 28 U. S. C. A. Section 347 (a); Rev. Stat. Section 1008 as amended (28 U. S. C. A. Section 350).

2. The date of the judgment of the Circuit Court of Appeals for the Ninth Circuit herein sought to be reviewed is May 14, 1941. [R. 96.]

3. The cases believed by your petitioner to sustain jurisdiction of this Court and relied on for the exercise thereof are referred to in the preceding petition, page 9, to which reference is made to avoid duplication.

Statement of the Case.

The facts have been set forth in the foregoing petition, to which reference is made, to avoid duplication. They show that the petitioner acquired title to all the assets of the two predecessor corporations through a bondholders' foreclosure proceedings and that the petitioner sought to use the predecessors' basis for computing depreciation for income tax purposes.

Assignments of Error.

1. The Circuit Court of Appeals for the Ninth Circuit erred in refusing to hold that the steps taken by the petitioner in acquiring the assets of the Palm Springs Hotel Co. and the El Mirador Hotel Operating Co. constituted a tax free reorganization whereby the petitioner as a party to the reorganization is entitled to the same basis for depreciation as the predecessor insolvent corporations.

2. The Circuit Court of Appeals for the Ninth Circuit erred in refusing to hold that this case is governed by the cases of *Commissioner v. Newberry L. & C. Co.*; 94 Fed. (2d) 447 (C. C. A. 6th); *Commissioner v. Kitselman,* 89 Fed. (2d) 458 (C. C. A. 7th); *Commissioner v. Southwest Consolidated Corporation,* 119 Fed. (2d) 561 (C. C. A. 5th), and *Commissioner v. Alabama Asphaltic Limestone Company, Inc.,* 119 Fed. (2d) 819 (C. C. A. 5th).

3. The Circuit Court of Appeals for the Ninth Circuit erred in holding that the cases of *LeTulle v. Scofield,* 308 U. S. 415, and *Helvering v. Tyng,* 308 U. S. 527 overruled the cases of *Newberry* and *Kitselman, supra.*

4. The Circuit Court of Appeals for the Ninth Circuit erred in rejecting the petitioner's contention that immediately after the above mentioned transfer an interest or control in the transferred property of 50 per centum or more remained in the same persons as before the transfer.

5. The Circuit Court of Appeals for the Ninth Circuit erred in holding that prior to the transfer the taxpayer had no interest or control in any of the property but was merely a creditor of the Hotel Company and the Operating Company.

6. The Circuit Court of Appeals for the Ninth Circuit erred in holding that the basis of the petitioner for the real and personal property was the cost thereof to the petitioner.

Summary of Argument.

The Palm Springs Hotel Co. and the El Mirador Hotel Operating Co. in 1932 were insolvent. The petitioner was the owner of approximately 95% of the outstanding bonds of the Palm Springs Hotel Co. which were a lien upon all of the property of the Palm Springs Hotel Co. By virtue of a foreclosure of the bond issue the petitioner acquired the chattel mortgage, lease and indebtedness of the El Mirador Hotel Operating Co. Owing to the insolvency of these two companies and the superior position of the petitioner as a holder of the bonds and chattel mortgage the petitioner was to all practical effects and purposes a stockholder of the two companies, owning an interest or control in excess of 95% of the assets in both companies because of the disappearance of the equities of the stockholders in the two predecessor corporations. Since the petitioner ultimately acquired all of the assets of the two companies by the issuance of its stock and the petitioner's stockholders were the virtual stockholders of the two predecessor companies, the steps by which it acquired all of the assets of the two old companies constituted a tax free reorganization and consequently petitioner is entitled to use the adjusted basis of the two old companies for the purpose of computing depreciation for income tax purposes.

Argument.

The petitioner held $292,000.00 par value out of $309,000.00 par value of the outstanding first mortgage bonds of the Palm Springs Hotel Co. [R. 23 and 26.] This was approximately 95% of the entire issue. These bonds were secured by an indenture which was a lien upon all of the assets of the obligor. [R. 23.] The Palm Springs Hotel Co. had leased the building to the El Mirador Hotel Operating Co., which latter company was the lessee of the hotel building. [R. 23.] The latter company gave to the Palm Springs Hotel Co. a chattel mortgage on its furniture and fixtures to secure the performance of the terms of the lease. [R. 23.] The Palm Springs Hotel Co. in turn pledged this lease and chattel mortgage as additional security under the indenture securing the bonds. [R. 23.] The Palm Springs Hotel Co. and the El Mirador Hotel Operating Co. were insolvent in 1932 [R. 24], at which time the petitioner was the owner of approximately 95% of the outstanding bonds. All except five shares of the stock of each of the Palm Springs Hotel Co. and the El Mirador Hotel Operating Co. had been sold for assessments and each company bought in all of its respective shares except five shares in each company which were retained by W. B. Pinney, who then became the sole stockholder in each of the two old companies. [R. 24 and 25.] This sole stockholder became a stockholder of the petitioner. [R. 29.]

In 1932 the trustee under the trust indenture sold all of the properties of the Palm Springs Hotel Co. includ-

ing the chattel mortgage and lease to the petitioner who bid $61,800.00 for the said assets. This bid was paid as follows:

Cash	$18,767.96
Bonds of Palm Springs Hotel Co. of the par value of $292,000	43,032.04
	$61,800.00 [R. 27.]

Thereafter the petitioner foreclosed the chattel mortgage given by the El Mirador Hotel Operating Co. in a court proceeding in which the petitioner procured a judgment of $77,918.79 on the said lease. The furniture and fixtures of the El Mirador Hotel Operating Co. were sold to the petitioner under said judgment for $20,179.25. These furniture and fixtures constituted all of the assets of the El Mirador Hotel Operating Co. [R. 28.]

All of said assets were acquired by the petitioner pursuant to a Plan of Reorganization which is set forth in a copy of the Bondholders' Protective Agreement. [R. 70-73 inclusive and 78-81 inclusive.]

The petitioner was entitled to deduct upon its Federal income tax return for its fiscal year ended May 31, 1936, depreciation upon its properties for income tax purposes. This deduction is provided for by Section 23 of the Revenue Act of 1934. [See Appendix for Statutes.] The controversy here arises over the basis to be used for that purpose. The petitioner claims the right to use the adjusted basis of the two old corporations whereas the Commissioner contends that the basis should be the fair market value as of the date of foreclosure. [R. 15.]

The Circuit Court Erred in Refusing to Hold That the Steps by Which the Petitioner Acquired All the Property of the Two Old Corporations Constituted a Tax Free Reorganization Which Entitles the Petitioner to Use the Adjusted Bases of the Old Companies in Computing Its Depreciation for Income Tax Purposes.

Under Section 113 of the Revenue Act of 1934 [see Appendix] the cost of property is the normal basis for computing depreciation. There are exceptions to this rule and it is the contention of the petitioner that the Circuit Court failed to follow a long line of decisions holding that similar transactions resulted in tax free reorganizations which give rise to one of the exceptions mentioned. Reference to Sections 114 (a) and 113 (a) (12) and 113 (b) of the Revenue Act of 1934 will disclose that the provisions of Section 112 (a) and (b), Section 113 (a) (7), and Section 114 (a) of the Revenue Act of 1932 govern the basis upon which the petitioner claims the right to compute depreciation for income tax purposes.

Section 113 (a) (7) of the Revenue Act of 1932, in effect, provides that if property was acquired after December 31, 1917, by a corporation in connection with a reorganization, and immediately after the transfer of an interest or control of such property of 50% or more remained in the same persons or any of them the basis for depreciation shall be the same as it would be in the hands of the transferor, with certain adjustments.

Section 112 (i) of the same Act defines the term "reorganization" as, among other things. (A) a merger or consolidated (including the acquisition by one corporation of at least a majority of the voting stock and at least a

majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred.

This section defines further the term "a party to a reorganization" as to include both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation.

Subsection (j) of the same section defines the word "control" as meaning at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of the corporation.

The petitioner's application for a Writ of Certiorari is grounded upon the fact that a number of cases in which the factual situations are very similar to the one at bar have been passed upon in the Circuit Courts of Appeals in at least six Circuits. With the exception of the Ninth Circuit, all of the Circuits in which the cases have arisen have held that a tax free reorganization resulted where bondholders foreclosed a bond issue and formed a new corporation to which the property of the obligor was transferred and the bondholders of the old company were the controlling stockholders of the new corporation. The leading case upon the subject is the case of *Commissioner v. Kitselman*, 89 Fed. (2d) 458 (C. C. A. 7th) (certiorari denied 302 U. S. 709). This case was followed in the case of *Commissioner v. Newberry L. & C. Co.*, 94 Fed.

(2d) 447 (C. C. A. 6th). The Circuit Court of Appeals for the Second, Fifth, Sixth, Seventh and Eighth Circuits have all determined the question in favor of the taxpayer. In addition to the *Kitselman* and *Newberry* cases the following is a list of the cases so determined in the various taxpayers' favor:

Commissioner v. Southwest Consolidated Corporation, 119 Fed. (2d) 561 (C. C. A. 5th), decided April 19, 1941;

Commissioner v. Alabama Asphaltic Limestone Company, 119 Fed. (2d) 819 (C. C. A. 5th), decided May 5, 1941;

Commissioner v. New Haven and Shore Line Railway Company, Inc., ... Fed. (2d) ..... (C. C. A. (2d), decided July 21st, 1941; reported in Prentice-Hall, 1941 Fed. Tax Service, par. 62,841;

Commissioner v. James Q. Newton Trust, ... Fed. (2d) ..... (C. C. A. 10th), decided July ...., 1941.

The Circuit Court of Appeals for the Ninth Circuit struck the first discordant note when it decided the cases of *Commissioner of Internal Revenue v. Bondholders Committee, et al.*, and *Commissioner of Internal Revenue v. Marlborough House, Inc.*, 118 Fed. (2d) 511, wherein the Court held that the opinion of the Supreme Court of the United States in the *LeTulle* case contained language broad enough to overrule the *Kitselman* and *Newberry* cases, and decided the cases against the taxpayers. Then followed the opinion of the Ninth Circuit in the instant case of *Commissioner v. Palm Springs Holding Corporation*, 119 Fed. (2d) 846, in which it was held that the *Kitselman* and *Newberry* cases were overruled by the *LeTulle* and *Tyng* cases.

In the case of *Commissioner v. New Haven & Shore Line R. R. Co., supra*, the Court said:

"The crux of the case at bar is therefore whether, since the seller was definitively insolvent—that is to say, since its shares could not possibly have any value—the bondholders were to be regarded as surrendering the same interest that they got back in the form of shares in the buyer. Did the seller's insolvency provide the required 'continuity of interest'? That question has come up five times, under the Act of 1928 or the Act of 1934, either as a question of 'recognizable' gain or loss, or of depreciation. Three circuit courts of appeal have held that there was a 'reorganization'—one of them since LeTulle v. Scofield, *supra* (308 U. S. 415) was decided. Commissioner v. Kitselman, 89 F. (2d) 458 (C. C. A. 7); Commissioner v. Newberry L. & C. Co., 94 F. (2d) 447 (C. C. A. 6); Commissioner v. Southwest Consolidated Corp., 119 F. (2d) 561 (C. C. A. 5), and Commissioner v. Alabama Asphaltic Co., 119 F. (2d) 819 (C. C. A. 5). The Ninth Circuit has, however, held otherwise, Commissioner v. Marlborough House, Inc., 118 F. (2d) 511. It seems to us that the majority has been right. Certainly LeTulle v. Scofield, *supra* (308 U. S. 415), had no such question in mind, in spite of its including Commissioner v. Kitselman in the note on page 420; it very explicitly put the decision on the fact that creditors, no matter how distant might be the maturity of their debts, had no interest in the debtor's property, even though they were secured by a lien."

It is submitted that the divergence between the Ninth Circuit and the other Circuits hereinbefore mentioned could only arise because of the misconstruction of the *LeTulle* and *Tyng* cases, *supra,* by the Circuit Court of Appeals for the Ninth Circuit.

In both the *LeTulle* and *Tyng* cases, stockholders of the transferor corporations received stocks, bonds and cash of the transferee corporations and thus were converted from stockholders of the transferor corporations into creditors of the transferee corporations. No insolvent corporations were involved, consequently, there was no continuity of interest in the assets of the transferors remaining in the hands of LeTulle and Tyng. In the instant case the two old corporations were insolvent as a consequence of which the bondholders were moved up to the status of stockholders and had approximately 95% interest and control in the assets of the two old companies. They received stock in the transferee corporation for their securities in the old corporations and they retained an interest or control of over 50% in the assets. Therefore, there exists here a continuity of interest that is lacking in the *LeTulle* and *Tyng* cases. This distinction was pointed out by the Board of Tax Appeals in the case of *Commissioner v. James Q. Newton,* 42 B. T. A. 473, at 483, in which the facts are comparable to those in the case at bar. The *Newton* case has been affirmed by the Circuit Court of Appeals for the Tenth Circuit.

It should be noted that in the *LeTulle* case your Honorable Court in a footnote cited the *Kitselman* case as an example of the difficulty in classifying securities involved in various cases. (308 U. S. at p. 420.) Inferentially, it would appear from this that the Supreme Court of the United States did not regard the *LeTulle* case as overruling the *Kitselman* case.

Analyses of the *LeTulle* decision are presented in C. C. H. Illustrative Bulletin E, May 8, 1940; The Meaning of LeTulle vs. Scofield, Silverson, 18 Tax Magazine, 492 (1940), Income Tax Problems of Reorganization, Virgil S. Chandler, December, 1940, University of Kansas City Law Review, Volume IX, page 22.

The Circuit Court of Appeals for the Ninth Circuit Has Decided an Important Question of Federal Law Which Has Not Been, But Should Be, Settled by the Supreme Court of the United States.

The principle involved in the present case is one of importance to a large number of taxpayers and, it is believed, has not been passed upon by your Honorable Court and the present case presents an appropriate situation which would justify the exercise of your Honorable Court's power of supervision.

Conclusions.

Since there is a conflict between the Circuit Court of Appeals for the Ninth Circuit and five other Circuits as hereinbefore pointed out it would seem appropriate that a Writ of Certiorari should be granted to reverse the decision of the Circuit Court of Appeals for the Ninth Circuit;

FIRST, because that decision is in conflict with the decisions of five other Circuits;

SECOND, the decision of the Ninth Circuit misapplies and misconstrues the holding in *LeTulle v. Scofield* and *Commissioner v. Tyng;*

THIRD, the holding of the Ninth Circuit is in conflict with more recent cases of *Commissioner v. Alabama Asphaltic Limestone Co.; Commissioner v. Southwest Consolidated Corporation, supra,* of the Fifth Circuit; *Commissioner v. New Haven & Shore Line R. R. Co., supra,* of the Second Circuit; and *Commissioner v. James Q. Newton Trust, supra,* of the Tenth Circuit;

FOURTH, the question of law involved is in confusion and should be clarified and is of wide importance in the administration of the Revenue Laws of the United States;

FIFTH, the decision of the Ninth Circuit is a departure from the accepted and usual decisions on the subject made and should be corrected.

Respectfully submitted,

THOMAS R. DEMPSEY,
Attorney for Petitioner.

APPENDIX.

Sections of the 1936 Revenue Act, 26 U. S. C. A.

Internal Revenue Acts:

SEC. 1. APPLICATION OF TITLE.

The provisions of this title shall apply only to taxable years beginning after December 31, 1935. Income, war-profits, and excess-profits taxes for taxable years beginning prior to January 1, 1936, shall not be affected by the provisions of this title, but shall remain subject to the applicable provisions of prior Revenue Acts, except as such provisions are modified by legislation enacted subsequent to this Act. (p. 819.)

Sections of the 1934 Revenue Act, 26 U. S. C. A., Internal Revenue Acts:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(1) Depreciation.—A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence. * * * (p. 673.)

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

(a) BASIS FOR DEPRECIATION.—The basis upon which exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the adjusted basis provided in section 113 (b) for the purpose of determining the gain upon the sale or other disposition of such property. (p. 701.)

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(b) ADJUSTED BASIS.—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided. (p. 700.)

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) Basis (Unadjusted) of Property. The basis of property shall be the cost of such property; except that—

(12) BASIS ESTABLISHED BY REVENUE ACT OF 1932.—If the property was acquired, after February 28, 1913, in any taxable year beginning prior to January 1, 1934, and the basis thereof, for the purpose of the Revenue Act of 1932 was prescribed by section 113 (a) (6), (7), or (9) of such Act, then for the purposes of this Act the basis shall be the same as the basis therein prescribed in the Revenue Act of 1932. (p. 700.)

Sections of the 1932 Revenue Act, 26 U. S. C. A., Internal Revenue Acts:

§114 BASIS FOR DEPRECIATION AND DEPLETION.

(a) Basis for Depreciation. The basis upon which exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the adjusted basis provided in section 113 (b) for the purpose of determining the gain or loss upon the sale or other disposition of such property. (p. 519.)

§113 ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(b) Adjusted Basis. The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided. (p. 518.)

§113 ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) Basis (Unadjusted) of Property. The basis of property shall be the cost of such property; except that—

(7) Transfers to corporation where control of property remains in same persons. If the property was acquired after December 31, 1917, by a corporation in connection with a reorganization, and immediately after the transfer an interest or control in such property of 50 per centum or more remained in the same persons or any of them then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made. This paragraph shall not apply if the property acquired consists of stock or securities in a corporation a party to the reorganization, unless acquired by the issuance of stock or securities of the transferee as the consideration in whole or in part for the transfer. (p. 516.)

§112 RECOGNITION OF GAIN OR LOSS.

(a) General Rule. Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) Exchanges Solely in Kind—

* * * (3) Stock for stock on reorganization. No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

(4) Same—Gain of corporation. No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

(5) Transfer to corporation controlled by transferor No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation; but in the case of an exchange by two or more persons this paragraph shall apply only if the amount of the stock and securities received by each is substantially in proportion to his interest in the property prior to the exchange. (p. 511.)

* * * * * * * * *

(i) Definition of Reorganization. As used in this section and sections 113 and 115—

(1) The term "reorganization" means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (B) a transfer

by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization, or (D) a mere change in identity, form, or place or organization, however effected.

(2) The term "a party to a reorganization" includes a corporation resulting from a reorganization and includes both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation. (pp. 513, 514.)

(j) Definition of Control.—As used in this section the term "control" means the ownership of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of the corporation.